

Members

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Sen. Roberk Jackman
Sen. David Long
Sen. John Broden
Sen. Glenn Howard
Sen. Larry Lutz
Rep. Ben GiaQuinta, Vice-Chairperson
Rep. Robert Kuzman
Rep. Vern Tincher
Rep. Woody Burton
Rep. Ralph Foley
Rep. Michael Smith



INTERIM STUDY COMMITTEE ON LIEN RECOVERY

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Authority: Legislative Council Resolution 01-02

MEETING MINUTES¹

Meeting Date: September 17, 2002
Meeting Time: 10:00 A.M.
Meeting Place: State House, 200 W. Washington
St., 233
Meeting City: Indianapolis, Indiana
Meeting Number: 1

Members Present: Sen. Luke Kenley, Chairperson; Sen. Roberk Jackman;
Sen. Glenn Howard; Sen. Larry Lutz; Rep. Ben GiaQuinta,
Vice-Chairperson; Rep. Woody Burton; Rep. Ralph Foley;
Rep. Michael Smith.

Members Absent: Sen. David Long; Sen. John Broden; Rep. Robert Kuzman;
Rep. Vern Tincher.

Call To Order

Senator Kenley called the meeting to order at 10:05 a.m. The committee members introduced themselves.

¹ Exhibits and other materials referenced in these minutes can be inspected and copied in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for copies may be mailed to the Legislative Information Center, Legislative Services Agency, 200 West Washington Street, Indianapolis, IN 46204-2789. A fee of \$0.15 per page and mailing costs will be charged for copies. These minutes are also available on the Internet at the General Assembly homepage. The URL address of the General Assembly homepage is <http://www.ai.org/legislative/>. No fee is charged for viewing, downloading, or printing minutes from the Internet.

Homeowner Lien Recovery Fund

John Barnett (Indiana Lumber and Builder's Supply Association, hereafter ILBSA) gave an overview of Michigan's Lien Recovery Fund. As part of his presentation Mr. Barnett distributed two reports, one entitled "A Survey of Recent Developments in Mechanic's Lien Law in Utah" (Exhibit A) and "Indiana Homeowner Lien Recovery Fund" (Exhibit B).

Representative Smith explained that he offered the resolution that gave rise to this committee. He noted a situation that arose in his district in which a lender foreclosed on a building/construction loan. However, a subcontractor was not notified of the foreclosure and continued to perform work on the project. The subcontractor was unable to recover the costs and expenses for this work. Representative Smith noted that some type of protection needs to be considered by the committee to prevent this type of situation from recurring.

Senator Howard expressed a concern about the possibility of similar problems with respect to building contracts awarded by the State of Indiana. Senator Howard suggested that Susan Williams be included in future discussions regarding this issue.

Ray Moistner (ILBSA) presented information on the Michigan Lien Recovery Fund. In Michigan, all licensed contractors are required to make a one time payment of \$50 to the lien recovery fund. The money accumulated in the fund is used to pay subcontractors and suppliers in the event that a property owner pays a general contractor who in turn fails to pay subcontractors and suppliers. The money in the fund is used to compensate the subcontractors and suppliers in lieu of requiring the property owner to in effect pay twice for the work.

Mr. Moistner went on to say that the establishment of the fund required no seed money from the Michigan legislature. He noted that the law creating the fund provides for a special assessment in the event that money in the fund falls below \$1,000,000. There has been only one special assessment, which occurred in 1999. In addition to required contributions from licensed contractors, Mr. Moistner indicated that non-licensed contractors and suppliers (roughly 30,000) voluntarily contribute to the Michigan fund. He explained that in Indiana general contractors and heating and air conditioning contractors are not licensed, so an Indiana fund would have to rely more heavily than Michigan on voluntary contributions.

Mr. Moistner next discussed expenses associated with the operation of the Michigan fund. He cited litigation costs and court fees as comprising roughly half of the operating expenses. He noted that the Utah legislature recently passed a law creating a fund which attempted to lessen these expenses. Other expenses include salaries paid to the Michigan Attorney General who provides a staff to represent the fund in court proceedings.

Mr. Moistner addressed problems with the Michigan fund. He first stated that perhaps the state should not be responsible for defending the fund. He explained that it is perhaps more cost effective to allow the parties to the dispute to reach a settlement and then petition the fund once settlement is reached. Additionally, the

Michigan fund allows a claimant to collect interest on claims. Mr. Moistner indicated that interest awards are often quite high, and that it may be beneficial to limit awards to principal only, or to cap the amount of interest that the fund will pay to a claimant. Lastly, Mr. Moistner explained that the creation of the fund has encouraged extensions of credit to unreliable risks with the understanding that the fund will serve as a back up.

Senator Kenley asked if the goal of the fund is to protect homeowners from being forced to pay twice for work. He went on to say that Indiana law empowers a property owner to use no lien contracts for construction of a home. He asked Mr. Moistner if he thought no lien contracts are sufficient to protect Indiana homeowners.

Mr. Moistner responded that the other goal of the fund is to protect subcontractors and suppliers.

Representative Burton asked if there was a cap on the amount of recovery from the fund. Belinda Wright (Assistant Administrator of the Michigan Lien Recovery Fund) responded that there is a \$75,000 per structure limit. She explained that if there are multiple claimants for combined amounts exceeding \$75,000, then the claimants share the amounts awarded from the fund on a pro rata basis. Representative Burton next asked if Michigan has penalties for a contractor who fails to pay subcontractors and suppliers for work performed. Mr. Moistner answered that license revocation is the usual penalty in Michigan, and Utah has enacted criminal penalties for nonpayment.

Representative Burton addressed Senator Kenley and asked if the committee should consider adding a provision to the Indiana lien law requiring a general contractor to notify a property owner of the owner's right to a no lien contract. Senator Kenley stated the matter should be considered.

Tom Martin (Legislative Liaison for the Michigan Department of Consumer and Industry Services) presented a historical outline of the creation of the Michigan fund. He continued by addressing five problem areas for the Michigan fund. First, he stated the fund should be self-perpetuating. The balance in the fund was at one time \$13,000 and there were many complaints when the special assessment occurred in 1999. Mr. Martin stated the best ways to avoid the need for reassessment are to pay principal only (not interest) on fund awards and to not pay time/price differentials. Second, he stated penalties for failure to pay assessments by non-licensed contractors are non-existent. Third, he explained that two companies were responsible for 35% of money paid out of the fund in 1999. Fourth, Mr. Martin explained that bankruptcy filings are often problematic for the fund. He stated that contractors should be required to notify the state prior to a bankruptcy proceeding. Fifth, he stated the legal expenses incurred by the fund are high, approximately 40% of the operating expenses. He remarked that Michigan's aggressive defense of the fund drives up the legal expenses, but probably also saves money by reducing the incidence of unwarranted payouts. He noted that it is difficult to find the right balance between these two interests.

Representative Foley asked if the staff at the Michigan attorney general's office is

paid from the fund. He followed up by asking for more specific information on the legal costs incurred by the fund. Mr. Martin responded by stating that the majority of the legal costs come from appearing in court as a defendant in a lien action. Belinda Wright added that there is a 20% cap on administrative cost expenditures. Representative Foley followed up by asking if the state bears the burden of the costs if expenditures exceed 20%. Ms. Wright answered no. The fund continues to bear the cost, but there is a negative consequence to the fund when an audit of the fund is performed.

Belinda Wright presented additional information on the Michigan fund. As part of her presentation she distributed a folder containing materials on the Michigan lien recovery fund (Exhibit C). Senator Kenley noted the earlier stated \$75,000 limit per structure on fund awards, and asked Ms. Wright what occurs if the claims are twice that amount. He asked Ms. Wright if the claimant can file other actions against the homeowner for amounts in excess of \$75,000. Ms. Wright responded that the fund will only pay out \$75,000, and the claimants must split that amount on a pro-rata basis. Mr. Moistner indicated that Michigan law may provide an avenue for the subcontractor or supplier to bring a further action against the homeowner for amounts in excess of the amount awarded from the fund.

Representative Foley asked Ms. Wright the annual cost of operating the fund. Ms. Wright responded that the cost is roughly \$1,000,000 per year, and the annual revenue (which primarily consists of new \$50 memberships and money recovered from defaulting contractors) is approximately \$650,000 per year.

Joseph Beckman (lumberyard owner who works in Michigan and Indiana) spoke in support of the fund. He stated that he pays into the Michigan fund and considers it an insurance policy. Mr. Beckman stated that in his 30 years of work in Indiana he has never encountered a homeowner using a no lien contract.

Senator Kenley stated that he is worried about the potential efficacy of the fund in Indiana because of non-licensure of contractors. He asked Mr. Beckman if he thought this type of fund could be created and administered privately. Mr. Beckman responded that he believes the industry is too fragmented to operate such a fund privately.

Changes to the Indiana Mechanic's Lien Law

Representative Burton suggested three changes to Indiana lien laws. First, he stated the time within which a notice of intention to hold a lien is required to be filed should uniformly be 60 days. Second, he suggested a supplier should be required to provide notice to a property owner if a contractor is delinquent in payment to the supplier. Representative Burton suggested a 60 day period within which notice must be filed. Third, he recommended the creation of a criminal penalty for a contractor who intentionally defaults on payments to suppliers and subcontractors.

Senator Kenley asked Representative Burton about the possibility that payment is withheld due to improper performance. Representative Burton agreed that improper performance is an issue that should be considered.

Senator Kenley asked Representative Smith if the discussion has addressed the concern he raised at the beginning of the meeting. Representative Smith responded that he did not believe the measures discussed by Representative Burton necessarily solved the problem in his district.

Senator Kenley commented that a subcontractor should have a duty to mitigate if the subcontractor knows or should reasonably know that the contractor is defaulting on payments.

Further Changes to Indiana Mechanic's Lien Law

Brock Jordan (attorney with Rubin and Levin) recommended four areas in the Indiana mechanic's lien law he felt the committee should consider amending. First, he suggested the time for filing an intention to hold a mechanic's lien should uniformly be 60 days. Second, he advocated a pre-lien notification requirement for subcontractors and suppliers who do work on residences and family dwellings. Third, he stated that if a property owner has fully paid a defaulting general contractor, then a subcontractor or supplier should not be permitted to file a lien against the property owner. Fourth, he suggested the awarding of attorney's fees should be amended. Mr. Jordan stated that the property owner is on the hook for attorney's fees if the full amount due under the contract has not been paid.

Adjournment

Senator Kenley adjourned the meeting at 11:55 a.m. He asked committee members to be prepared to further discuss the: (1) Michigan lien fund proposal; (2) issues raised by Representative Burton; (3) issues raised by Brock Jordan; and (4) duty of a subcontractor to mitigate if the subcontractor knows or reasonably should know the contractor is defaulting on payments.